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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes	)	CC Docket No. 92-133

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Reply Comments

BellSouth Telecommunications, Inc. and BellSouth Corporation ("BellSouth") hereby offer Reply Comments in the captioned proceeding in accordance with the Commission's Notice of Proposed Rulemaking, FCC 92-256, released July 14, 1992. BellSouth participated in the preparation of Reply Comments by the United States Telephone Association ("USTA"), and adopts the views expressed by USTA therein. BellSouth will not repeat those views in this pleading. However, BellSouth wishes to reply specifically to certain statements made in the comments of MCI Telecommunications Corporation ("MCI") and the General Services Administration ("GSA").

GSA asserts that the cost of capital of the local exchange carriers ("LECs") has fallen precipitously since the last rate of return prescription, warranting an immediate represcription proceeding.[1] To support this conclusion, GSA cites the decline in the spot yields on

[1]GSA Comments at 10.

intermediate Treasury notes since 1990. GSA's position is interesting, since in the 1990 represcription proceeding, GSA specifically urged the Commission to disregard the increase in Treasury yields that had occurred since the last represcription in 1986. In its Responsive Submission, GSA's expert, Dr. Winter, urged the Commission to reject the use of the yields of Treasury securities as evidence of LEC capital costs.[2] Now GSA urges the Commission to consider the subsequent decline in this measure as evidence that LEC capital costs have decreased. Such patently inconsistent and biased recommendations deserve no consideration from the Commission.

The facts are that spot yields on Treasury securities are now at approximately the same level as they were in 1986, when the Commission prescribed an overall rate of return of 12 percent for the LECs. For example, when the FCC first prescribed a 12 percent overall rate of return for the LECs in 1986, the spot yield on one year Treasury notes was 5.9 percent and on 30 year Treasury bonds was 7.3 percent.[3] The spot yield on ten year Treasury notes was

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[2]See, In the Matter of Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89-624, GSA Responsive Submission, Winter Statement at 20-21.

[3]Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, 5 FCC Rcd 7507 (1990) ("1990 Represcription Order"), recon., 6 FCC Rcd. 7193 (1991) at para. 170.

averaging around 7.0 percent.[4] Current spot yields on ten year Treasury bonds are about 6.5 percent, and on 30 year Treasury bonds are at about 7.5 percent.[5] Insummary, GSA in 1990 urged the Commission to ignore the increase in Treasury yields that had occurred since 1986. The Commission did so. Now that Treasury yields have returned to their 1986 levels, GSA asks the Commission to rely on the change since 1990 to immediately reduce the LECs authorized rate of return. The patent inconsistency in GSA's positions clearly warrants the rejection of its arguments by the Commission. No represcription proceeding is warranted at this time.

GSA's conclusions are a product of its proposed trigger mechanism, which relies upon spot yields of intermediate term Treasury notes. Treasury notes are more volatile than either long term debt or equity costs, and therefore are not a good source for a trigger mechanism that would initiate a new rate of return prescription. Because of the greater volatility in Treasury note spot yields, the Commission has considered a 12 month moving average as a technique to smooth out the fluctuations.[6] It is for that reason that USTA recommends a rolling average of long term bonds, rather than spot yields of intermediate term notes, as a trigger mechanism to detect significant and persistent changes in

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[4]1990 Represcription Order , Appendix H.

[5]Wall Street Journal, October 8, 1992.

[6]1990 Represcription Order, Appendix H.

the cost of capital to the LECs. For the reasons noted above, BellSouth opposes both GSA's proposed trigger mechanism and its conclusion that a new prescription proceeding is warranted at this time.

GSA also suggests that any represcribed rate of return be applied immediately to adjust the sharing points of the price cap LECs. Such a proposal is contrary to the Commission's price cap orders and would alter fundamentally the incentive structure that price cap regulation was designed to foster. Such a mechanism would convert price cap regulation into a banded rate of return mechanism with a price cap overlay. Any changes in the LEC price cap plan should be adopted only in a proceeding that affords interested parties a full opportunity to comment on such issues. The Commission should reject GSA's request for fundamental changes in price caps in this proceeding as an untimely petition for reconsideration of the LEC price cap order.

MCI opposes the use of long term interest rates as a trigger mechanism based on the assertion that interest rates "would not have been a useful trigger for the 1990 Represcription Proceeding, since they did not signal the decline in capital costs that occurred between the 1986 Represcription Order and the 1990 Represcription Order."[7] The failure of interest rates to signal a decline in the LEC

[7]MCI Comments at 5.

cost of capital during this period should not be surprising, since there was no decline in the cost of capital during this period. Indeed, the Commission staff's own data repudiates a decline in capital costs between the time of the 1986 and 1990 represcription orders.

In the 1986 Represcription Order,[8] in which the FCC first prescribed a 12.0 percent overall rate of return, the Commission had available and considered RHC stock price data through August, 1986.[9] The Commission included its staff's analysis of the RHCs' cost of equity of the RHCs in Appendix E of the 1990 Represcription Order. There the Commission staff calculated the cost of equity as 13.13 percent at the start of the third quarter of 1986 to 12.42 percent at the end of that quarter. By comparison, in the 1990 Represcription Order the Commission found the unadjusted cost of equity of the RHCs to be in the range of 12.6 percent to 13.0 percent.[10] Thus, based on the Commission's own calculations, there was no measurable decline in the RHC cost of equity capital between the time the Commission first prescribed a 12.0 percent overall rate of return for the LECs and the time that it reduced the LECs' authorized

[8]Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800, Phase III, Memorandum Opinion and Order, 60 Rad. Reg. 2nd 1589 (1986) ("1986 Represcription Order").

[9]1986 Represcription Order, para. 46.

[10]1990 Represcription Order, 5 FCC Rcd at 7529.

overall rate of return to 11.25 percent in the 1990 Represcription Order.

An examination of interest rate information leads to the same result. In the 1990 Represcription Order, the Commission conceded that interest rates had increased since it prescribed the 12.0 percent overall rate of return in 1986.[11] Thus, the reason that the interest rate information failed to signal a decline in LEC capital costs between the time of the 1986 Represcription Order and the 1990 Represcription Order is apparent: there was no such decline. The Commission's decision to reduce the authorized rate of return of the LECs in 1990 was a policy decision that did not reflect any actual decline in capital costs.[12] Thus, MCI's criticism of interest rate information as a potential trigger for a represcription proceeding is without merit.

MCI also "opposes the Commission's tentative decision to repeal the 'automatic refund rule.'"[13] MCI misinterprets

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[11]See 1990 Represcription Order, para. 170, where the Commission states: "In 1986, the time of our first represcription, interest rates were in the range of 5.9% on one year treasury notes and 7.3% on thirty year treasury bonds. Interest rates as of June, 1990 were in the range of 8.0% on one year treasury notes and 8.4% on thirty year treasury bonds. The parties debate whether this increase in interest rates since 1986 mandates an increase in our prescribed rate of return."

[12]The 1990 Represcription Order is currently pending review in the United States Court of Appeals for the District of Columbia Circuit sub nom. Illinois Bell Telephone Company et al. v. FCC, No. 91-1020 and consolidated cases.

[13]MCI Comments at 30.

the current status of the Commission's enforcement rules. The Commission adopted rate of return enforcement rules[14] in Phase I of CC Docket No. 84-800. BellSouth and others petitioned for review of the enforcement rules. In AT&T v. FCC, 836 F.2d 1386 (D.C. Cir. 1988), the Court of Appeals granted the petitions for review and remanded the Phase I Orders to the Commission for further action consistent with the Court's opinion.[15] On September 3, 1992, the Commission terminated CC Docket No. 84-800 without acting on the remand.[16] Therefore, Subpart F of the Commission's Rules no longer exists. MCI's request that the Commission not "repeal" the enforcement rules therefore is misplaced. What is at issue in this proceeding is whether new enforcement rules should be adopted.

MCI suggests that the Commission simply reinstate the same automatic refund mechanism that the court struck down in AT&T v. FCC. MCI's rationale is that the Commission's clarification of its understanding of a rate of return prescription in the 1990 Represcription Order resolves the concerns that led the Court to reverse the Phase I Orders.[17]

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[14]Subpart F of Part 65 of the Commission's Rules, 47 C.F.R. Sec. 65.700 et seq.

[15]AT&T v. FCC, 836 F.2d at 1393.

[16]In the Matter of Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Companies, CC Docket No. 84-800, Order, FCC 92-371, released September 3, 1992.

[17]MCI Comments at 31.

MCI is wrong.

In the 1990 Represcription Order, the Commission clarified that its prescribed rate of return is simply one point within a "zone of reasonableness", not a unique balance point that is both a minimum and a maximum.[18] Indeed, in the 1990 Represcription Order, the Commission selected a point near the middle of its estimated cost of capital range.[19] This fact completely undercuts MCI's argument.

MCI concedes, as it must, that the Commission currently views its prescribed rate of return (plus a small buffer) as a maximum.[20] Under the Commission's current interpretation, a carrier that achieves an earned return in excess of this maximum violates the Communications Act.[21] But to be consistent with this view of the effect of a rate of return prescription, the Commission would have to set the prescribed rate of return at the upper end of the "zone of reasonableness". This the Commission clearly did not do in the 1990 Represcription Order. Therefore, were the

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[18] 1990 Represcription Order, 5 FCC Rcd. at 7532, para. 217.

[19] Id. at para. 214.

[20] MCI Comments at 31.

[21] MCI v. Pacific Northwest Bell, 5 FCC Rcd 216 (1990); AT&T v. Northwestern Bell, 5 FCC Rcd. 143 (1990), apps. dismissed sub nom. Mountain States Tel. and Tel. Co. v. FCC, 951 F.2d 1259 (10th Cir. 1991). The Commission's decisions in this regard are merely interlocutory, as no final ruling has been made in either of these cases.

Commission to accept MCI's invitation to simply reinstate the enforcement rules struck down in AT&T v. FCC, the Commission would be committing patently reversible error. The Commission's enforcement rules and its actions in the 1990 Represcription Order would still amount to "a self-contradiction".[22]

BellSouth strongly recommends that the Commission extricate itself from the morass of automatic enforcement rules and rely instead on the tariff review process to assure itself that rates are properly targeted to comply with the prescribed rate of return. MCI's proposal would simply enmesh the Commission in additional years of fruitless litigation with little probability of success.

Respectfully submitted

BELLSOUTH TELECOMMUNICATIONS, INC.
and BELLSOUTH CORPORATION

By: M. Robert Sutherland
William B. Barfield
M. Robert Sutherland

Their Attorneys
1155 Peachtree Street, N.E.
Suite 1800
Atlanta, Georgia 30367-6000
(404) 249-2647

October 13, 1992

[22] AT&T v. FCC, 836 F.2d at 1391.

CERTIFICATE OF SERVICE

I hereby certify that I have this 13th day of October, 1992 serviced all parties to this action with a copy of the foregoing REPLY COMMENTS by placing a true and correct copy of same in the United States mail, postage prepaid, to those persons listed on the attached service list.

Susan V. Queen

Susan V. Queen

Delhi Telephone Company
Curtis W. Barker
Vice President/Gen. Mgr.
P.O. Box 217
Delhi, New York 13753

Lexington Telephone Company
B. Earl Hester, Jr.
P.O. Box 808
Lexington, NC 27293-0808

Topsham Telephone Company, Inc.
Frank M. Sahlman, Sr., Pres.
Box 1075
East Corinth, VT 05040

Roanoke/Botetourt Telephone Co.
J. Allen Layman
President and CEO
P.O. Box 174
Daneville, VA 24083

Nebraska Central Telephone Co.
Andrew D. Jader
Vice President - Administration
P.O. Box 700
Gibbon, Nebraska 68840

Rochester Telephone Company
Alan B. Terrell
President
P.O. Box 507
Rochester, Indiana 46975

Rochester Telephone Corporation
Josephine S. Trubek
General Counsel
180 South Clinton Avenue
Rochester, NY 14646

National Exchange Carrier
Association
Joanne S. Bochis
Associate General Counsel
100 S. Jefferson Road
Whippany, NJ 07981

U.S. Telephone Association
Martin T. McCue
Vice President/Gen. Counsel
900 19th Street, NW - Ste. 800
Washington, DC 20006-2105

Fred Williamson & Assos.
Marc A. Stone, Manager
2921 E. 91st Street
Suite 200
Tulsa, Oklahoma 74137-3300

National Telephone Cooperative
Association
David Cosson
L. Marie Gillory
2626 Pennsylvania Ave., NW
Washington, DC 20037

U S West Communications, Inc.
Lawrence E. Sarjeant
Robert B. McKenna
1020 19th Street, NW - Ste. 700
Washington, DC 20036

Southwestern Bell Telephone Co.
Durwood D. Dupre
Richard C. Hartgrove
1010 Pine Street, Room 2114
St. Louis, Missouri 63101

Pacific Bell/Nevada Bell
James P. Tuthill
140 New Montgomery St.
Room 1526
San Francisco, CA 94105

Bell Atlantic Telephone
Companies
Leslie A. Vial
1710 "H" Street, NW
Washington, DC 20006

Central Telephone Company
Theodore D. Frank
Vonya B. McCann
Arent, Fox, Kintner, Plotkin
& Kahn
1050 Connecticut Avenue, NW
Washington, DC 20036-5339

Nicholville Telephone Co., Inc.
Donald W. Gruneisen
P.O. Box 122
Nicholville, NY 12965-0122

Central Telephone Company
Carol F. Sulkes, Vice Pres.
Regulatory Policy
8745 Higgins Road
Chicago, Illinois 60631

Organization for the Protection
and Advancement of Small
Telephone Companies
John N. Rose
Executive Vice President
2000 "K" Street, NW - Ste. 205
Washington, DC 20006

U.S. Small Business
Administration
Office for Advocacy
Thomas P. Kerester
Barry Pineles
409 3rd Street, SW
Washington, DC 20416

Southern New England Tele. Co.
Linda D. Hershman
Vice President-External Affairs
227 Church Street
New Haven, CT 06506

United Telephone Companies
Jay C. Keithley
Vice President/Law and
External Affairs
1850 M Street, NW - 11th Floor
Washington, DC 20036

General Services Administration
Dennis Mullins, Gen. Counsel
Vincent L. Crivella
18th & F Streets, NW
Room 4002
Washington, DC 20405

Alltel Services Corporation
Carolyn C. Hill
1710 Rhode Island Avenue, NW
Suite 1000
Washington, DC 20036

MCI Telecommunications Corp.
Frank W. Krogh
Donald J. Elardo
1801 Pennsylvania Ave., NW
Washington, DC 20006

Cincinnati Bell Telephone Co.
Thomas E. Taylor
William D. Baskett, III
2500 Central Trust Center
201 East Fifth Street
Cincinnati, Ohio 45202